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Will C-36 Undermine CPP "9.9"? Benefit Enhancement and the Sustainability of the Canada Pension Plan

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The Canada Pension Plan, like all pension plans and social-security programs, is under constant tension. On one side are current and hopeful beneficiaries, who typically want richer payouts. On the other are younger actual or potential contributors, who typically want lower or at least sustainable contribution rates. The CPP's history reflects this tension: the repeated benefit enrichment, rising costs and growing unfunded liabilities that marked the 1970s and 1980s preceded reforms in the 1990s that trimmed benefits, ramped up contributions, and aimed to pre-fund enough of the program to hold its contribution rate at 9.9 percent.

For almost a decade since, the CPP has been stable. The need to cover earlier unfunded payouts to the baby boomers' parents still means that — if the plan evolves as envisioned in recent actuarial reports — young Canadians will pay more than their benefits are worth. But politicians have resisted the temptation to worsen the deal. Healthy revenues and strong investment returns from a robust economy have bolstered the funds in the plan. Although rising longevity and falling fertility have raised projected costs, successive actuarial reports have shown that the CPP could likely meet its obligations at a "steady state" contribution rate slightly below 9.9 percent.

Now the reshaped plan faces its first significant change — a proposed amendment that neatly embodies its tensions. Bill C-36, now making its way through Parliament, would do two things. It would ease access to disability benefits for older participants. And it would give effect to a commitment in the mid-1990s reforms to reflect the cost of future benefit enhancements in the contribution rate right away, rather than passing the bill ahead in time. So for those interested in the CPP's stability, Bill C-36 is both good news and bad news. The bad news is that the margin good fortune has created between the 9.9 percent rate and the current estimate of the steady-state rate has prompted an enrichment of benefits. The good news is that the Plan's masters must inform Canadians exactly what the price of that enrichment will be.

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Not everyone will agree that the enhanced access to CPP disability benefits Bill C-36 would create is a bad thing. The reforms of the 1990s aimed to contain rapid growth in disability payments, in part by restricting eligibility to people who have made minimum contributions in four of the last six years.[1] Bill C-36 would let people who have contributed to the plan for 25 years or more claim if they made minimum contributions in only three of the last six years.

Such proposals are always hard to address, since they set the concerns of actual or potential beneficiaries against those of contributors. As for the beneficiaries, denying disability benefits to a relatively small number of people — roughly 3,700, and about a quarter as many dependent children, by 2010 (OCA 2006, 19) — who demonstrated clear workforce attachment and have contributed for a quarter of a century, seems harsh: provincial social-assistance programs for disabled workers tend to pay less than CPP disability. Yet recent workforce attachment is surely more pertinent than length of contributions in judging whether a person is genuinely a disabled worker. And experience prior to the reforms of the 1990s has shown what other countries have learned to their cost: that apparently small changes in disability provisions can trigger large changes in payments.[2]

The stakes in this decision become clearer thanks to Bill C-36's second set of provisions: those that would bring the cost of higher benefits into estimates of the steady-state contribution rate right away. The most recent estimate of the CPP's steady-state contribution rate is in the Chief Actuary's report on the CPP at the end of 2003. It estimated that the lowest rate that would make the ratio of the plan's assets to its annual expenditures the same 13 and 63 years after the evaluation — the benchmark for judging stability — was 9.77 percent (OCA 2004). Under Bill C-36, the impact of the new disability provisions on that rate would have two elements: a temporary increase reflecting past-service obligations created by the new provisions, which will be amortized over 15 years; and a permanent increase reflecting the higher obligations the new provisions will create in the future. The Chief Actuary has estimated the impact of the provisions on the contribution rate at about 0.02 percent — slightly higher during the 15-year amortization period for the past-service obligations, and slightly lower afterward (OCA 2006, pp. 16-19). Bill C-36 would reflect these higher costs in the steady-state calculation, raising it from 9.77 percent to 9.79 percent.

The new steady-state rate would still be less than the legislated 9.9 percent rate, which gives the change an appearance of affordability. But while a change that uses up less than one-sixth of the margin between the previous steady-state rate and the legislated rate may seem small, it has a worrying message for proponents of long-term stability in the CPP. The recent crisis in Canada's occupational pension plans arose largely because a temporary spell of good fortune that created surpluses in these plans gave rise to overwhelming pressure to enrich benefits and/or cut current contributions. Then, when the normal ups and downs of the economy and financial markets turned against the plans, they

1 Contributions on earnings exceeding about one-tenth of the year's maximum pensionable earnings (YMPE) are necessary to qualify for disability benefits. In 2007, the YMPE is $43,700; the earnings threshold disability coverage is $4,300.

2 A sensitivity test on a potential increase in disability incidence shows an impact on the contribution rate more than a quarter again as great as in the baseline scenario (OCA 2006, 23).

ran into deficits. As a result, they must now renege on some of those higher benefits, or impose higher costs on future contributors.

For the CPP, which is nowhere close to being fully funded, the 9.9 percent contribution rate is the high-profile benchmark of sustainability. Good fortune has yielded a recent estimate of the steady-state rate below that. But for the CPP, too, lean years can follow fat ones. The same report that estimated the 9.77 rate also showed how less happy but quite realistic demographic, economic and cost assumptions could yield a steady-state rate above 10 percent (OCA 2004, 109). Bad breaks on more than one front could push the rate above 11 or even 12 percent. The margin that Bill C-36 would eat into is one that younger Canadians might like to preserve against future setbacks.

On balance, those advocating higher benefits and those advocating stable costs might see Bill C-36 as a reasonable tradeoff: a modest disability liberalization on the one hand, and a new contribution-rate formula that brings the cost of such benefit increases into the calculation right away, thus bolstering the plan against further cost increases in the future. The larger message of Bill C-36, however, is that the intergenerational tension in all pension plans still afflicts Canada's social security system. A run of good economic and financial-market performance since the reforms of the late 1990s opened a margin between the steady-state rate and the 9.9 percent rate legislated by the reforms. Bill C-36 would use up part of that margin. Advocates of stability in the CPP will need to ensure, when the next pressure for benefit expansion arises, that the new cost calculations inform the debate. Otherwise, incremental cost increases will, over time, put the CPP's 9.9 percent contribution rate at risk.

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